BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

June 20, 2013

Eric F. Grossman, Esq.
Chief Legal Officer
Morgan Stanley
1585 Broadway
New York, New York 10036

Dear Mr. Grossman:

This is in response to the notice by Morgan Stanley requesting the Board's prior approval of its proposed acquisition of additional shares of Morgan Stanley Smith Barney Holdings LLC ("MSSB"), currently a joint venture between Morgan Stanley and Citigroup Inc. ("Citigroup"), all of New York, New York. The notice is required under section 163(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[1]

Morgan Stanley is a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act").[2] MSSB engages in the following activities under the BHC Act: (1) underwriting, dealing in, and making a market in securities pursuant to section 4(k)(4)(E);[3] (2) life insurance and annuity advisory activities pursuant to section 4(k)(4)(B);[4] and (3) other financial activities that are closely related to banking pursuant to section 4(k)(4)(F).[5]

[1] Pub. L. No. 111-203, § 163(b), 124 Stat. 1376, 1422-23 (2010), codified at 12 U.S.C. § 5363(b).

[2] 12 U.S.C. § 1843(*l*).

[3] 12 U.S.C. § 1843(k)(4)(E).

[4] 12 U.S.C. § 1843(k)(4)(B).

[5] 12 U.S.C. § 1843(k)(4)(F). Those other activities include credit extensions (12 CFR 225.28(b)(1)), trust company functions (12 CFR 225.28(b)(5)), financial and investment advisory activities (12 CFR 225.28(b)(6)), securities brokerage and other agency transactional services (12 CFR 225.28(b)(7)), and investing and trading activities in foreign exchange, forward contracts, options, and futures

Morgan Stanley and Citigroup established MSSB as a joint venture in 2009 by combining Morgan Stanley's global wealth management group with various Citigroup business lines. Morgan Stanley initially owned 51 percent of MSSB and held options to acquire Citigroup's 49 percent interest in three one-year increments, beginning in 2012.[6] On May 24, 2012, the Board approved Morgan Stanley's proposal to exercise the first of the options and acquire an additional 14 percent interest in MSSB from Citigroup ("2012 Approval").[7] Subsequently, Morgan Stanley and Citigroup amended their original agreement to permit Morgan Stanley to acquire all of Citigroup's remaining ownership interest in MSSB at any time. Morgan Stanley now proposes to acquire the remaining 35 percent interest in MSSB from Citigroup.

Section 4(k) of the BHC Act generally permits financial holding companies to acquire shares of companies that conduct activities that are financial in nature without prior Board approval.[8] However, section 163(b) of the Dodd-Frank Act provides an exception to the general rule and requires Board approval before a bank holding company with assets of $50 billion or more may acquire shares of a company with assets of $10 billion or more that is engaged in activities under section 4(k) of the BHC Act. Morgan Stanley and MSSB exceed those asset thresholds.[9] Accordingly, Morgan Stanley's acquisition of the remaining 35 percent interest in MSSB requires the Board's prior approval.[10]

(12 CFR 225.28(b)(8)).

6 Under the initial agreement, Morgan Stanley had options to acquire the following interests in MSSB: (1) 14 percent, exercisable beginning June 1, 2012; (2) 15 percent, exercisable beginning June 1, 2013; and (3) the remaining 20 percent, exercisable beginning June 1, 2014.

7 See Board Letter to Eric F. Grossman, Esq., dated May 24, 2012.

8 12 U.S.C. § 1843(k)(6).

9 As of March 31, 2013, Morgan Stanley had total consolidated assets of $801 billion, and MSSB had total consolidated assets of $46.9 billion.

10 Section 163(b)(2) of the Dodd-Frank Act provides an exemption to the prior notice requirement for the acquisition of shares that would qualify for the exemptions in sections 4(c) or 4(k)(4)(E) of the BHC Act. 12 U.S.C. § 5363(b)(4). Morgan Stanley's proposed acquisition of additional shares of MSSB is not eligible for the exemptions in section 4(c). In addition, because MSSB engages in activities other than underwriting, dealing in, or making a market in securities, the

Section 163(b) of the Dodd-Frank Act provides that the standards listed in section 4(j)(2) of the BHC Act shall apply to transactions subject to section 163.[11] Accordingly, the Board has considered whether the proposed acquisition can "reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, unsound banking practices, or risk to the stability of the United States banking or financial system."[12] In addition, as required by section 163(b)(4) of the Dodd-Frank Act, the Board has considered the extent to which the proposed acquisition "would result in greater or more concentrated risks to global or United States financial stability or the United States economy."[13] Under those standards, and as discussed more fully below, the Board has considered the financial and managerial resources of the companies involved, the effect of the proposal on competition in the relevant markets, the risk to financial stability and to the United States banking and financial system and economy, and the public benefits of the proposal.

Financial and Managerial Resources. In reviewing the financial resources of Morgan Stanley and MSSB, the Board has considered the financial condition of both organizations, including their capital adequacy, asset quality, and earnings performance. The Board also has evaluated the pro forma financial condition of Morgan Stanley after consummation, including its projected capital position, asset quality, and earnings projections, and the impact of the proposed funding of the transaction. The proposed transaction is structured as a cash purchase of shares for a total of $4.725 billion.[14] Morgan Stanley's regulatory capital ratios exceed the minimums required of well-capitalized bank holding companies and would continue to do so on consummation of the proposal.

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proposed transaction does not qualify for the exemption in section 4(k)(4)(E) of the BHC Act.

[11] 12 U.S.C. § 5363(b)(4).

[12] 12 U.S.C. § 1843(j)(2).

[13] 12 U.S.C. § 5363(b)(4).

[14] In addition to the purchase price, Morgan Stanley expects that it or an affiliate will repay approximately $2 billion in preferred equity interests of MSSB and $880 million in outstanding long-term debt of MSSB held by Citigroup. Morgan Stanley will use existing resources to purchase the remaining 35 percent interest in MSSB and repay the preferred equity interests and long-term debt.

Consummation of the proposed transaction is also expected to enhance Morgan Stanley's earnings performance because of its right to receive an additional 35 percent of the revenues generated by MSSB.

The Board also has considered the managerial resources of the organizations involved and, in particular, has reviewed the examination records of Morgan Stanley and its subsidiary depository institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experience with Morgan Stanley since it became a financial holding company in late 2008. Morgan Stanley currently has operational control of MSSB, and MSSB is included in Morgan Stanley's consolidated financial statements. Under Morgan Stanley's operational control, MSSB has devoted significant resources to initiatives designed to integrate legacy business lines of Morgan Stanley and Citigroup. Since the 2012 Approval, MSSB has completed the establishment of, and transitioned nearly all of its clients to, a new operating platform.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources of the organizations involved in the proposal are consistent with approval.

Competitive Considerations. In addition, the Board has considered the competitive effects of Morgan Stanley's proposed acquisition of the remaining 35 percent interest in MSSB. As noted above, Morgan Stanley currently owns 65 percent of MSSB. Morgan Stanley already is deemed to control MSSB for purposes of the BHC Act, and MSSB is included in Morgan Stanley's consolidated financial statements. Based on all the facts of record, the Board has concluded that consummation of the proposed transaction would not have a significantly adverse effect on competition or on the concentration of resources in any relevant market and that competitive considerations are consistent with approval.

Financial Stability. The Board also has considered risk the proposal may pose to the stability of the United States banking and financial system and the extent to which the proposed acquisition would result in greater or more concentrated risks to global or United States financial stability and the United States economy. In evaluating the effects of the proposed transaction on financial stability, the Board considers the size of the resulting firm; availability of substitute providers for any critical products and services offered by the resulting firm; interconnectedness of the resulting firm with the banking or financial system; extent to which the resulting firm contributes to the complexity of the financial system; and the extent of the cross-border activities of the resulting firm. The proposed transaction would increase Morgan Stanley's consolidated liabilities and deposits by approximately $56 billion. The Board has also considered that Morgan Stanley already owns 65 percent of the voting shares of MSSB and currently consolidates MSSB in its financial statements. The transaction would not increase Morgan Stanley's complexity or cross-border activities, and it would not affect the availability of substitute providers of Morgan Stanley or MSSB's products and services. In addition, the elimination of MSSB's joint venture structure would significantly reduce the degree to which Morgan Stanley and Citigroup are interconnected. Based on all the facts of record, the Board has determined that considerations relating to financial stability are consistent with approval.

Public Benefits. The Board has taken these and other considerations into account in reviewing the public benefits and possible adverse effects of the proposal. The transaction is expected to enhance Morgan Stanley's earnings performance as a result of its right to receive an additional 35 percent of the revenues generated by MSSB. The transaction also is expected to reduce operating costs and operational risks by allowing the termination of agreements that previously required MSSB to route certain customer orders through Citigroup. As noted above, the severance of the joint venture relationship between Morgan Stanley and Citigroup will significantly reduce the interconnections between the two firms and decrease the possibility that financial distress at one firm could be transmitted to the other. Further, elimination of the joint venture structure would remove barriers to the marketability of MSSB if Morgan Stanley were to sell its interest in the company. In addition, Morgan Stanley has improved the operations of MSSB through integration initiatives, and the proposed transaction would provide additional incentive for Morgan Stanley to enhance MSSB's performance by fully aligning Morgan Stanley's economic interests with its managerial control of MSSB.

Moreover, in light of Morgan Stanley's existing operational control and financial consolidation of MSSB, consummation of the proposal is not likely to result in significant adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, unsound banking practices, risk to the stability of the United States banking or financial system, or greater or more concentrated risks to global or United States financial stability or the United States economy. Accordingly, based on all the facts of record, the Board has determined that the balance of the public benefits it must consider is consistent with approval.

Based on all the facts of record, the Board has determined that the notice should be, and hereby is, approved. In making this determination, the Board has relied on all the information and representations provided by Morgan Stanley in connection with the notice. This determination also is subject to the Board's authority to require modification or termination of the activities of a bank holding company or any of its subsidiaries as the Board finds necessary to ensure compliance with, or prevent evasion of, the provisions and purposes of the BHC Act and the Board's regulations and orders issued thereunder.

Please advise the Federal Reserve Bank of New York in writing when the transaction is consummated.

Sincerely yours,

Robert deV. Frierson

Robert deV. Frierson
Secretary of the Board

cc: Ivan J. Hurwitz, Vice President
Federal Reserve Bank of New York